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PENDING U.S. LEGISLATION TO PROHIBIT OFFSHORE INTERNET GAMBLING MAY PROLIFERATE MONEY LAUNDERING

Susan Ormand*

I. INTRODUCTION

HEAVY marketing of internet gambling web sites to the United States has caused an explosion of online sports-betting. As a result, U.S. legislators are taking action by proposing legislation aimed at financial payment systems. While gambling is illegal in most of the United States and federal law prohibits extraterritorial gambling, online bookmakers freely operate in the Caribbean and Central America, where laws are more relaxed.¹ The U.S. General Accounting Office estimated global revenues from internet gambling in 2003 totaled \$4 billion.²

Three bills limiting internet gambling are currently pending in Congress. House Bill 2143, the Unlawful Internet Gambling Funding Prohibition Act, has recently passed the House with high expectations of receiving the President's signature before year's end, pending Senate approval.³ Still, offshore bookmakers, many of them American citizens anticipating this legislation, are finding ways to circumvent the new rules and keep their very lucrative operations productive—with some doing so at the cost of their own exile.⁴

This case note examines offshore gambling web sites, the relevant U.S. laws in place, the proposed legislation to curb such illegal transactions, and the foreseeable response of offshore bookmakers.

II. OFFSHORE GAMBLING IN THE UNITED STATES

Costa Rica is heavily traveled because of its unspoiled shores and lush scenery. More recently it has attracted businesses eager to benefit from a

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1. Bob Tedeschi, *E-Commerce Report: Congress Wants to Put More Restrictions on Online Gambling, and the Sues Look for Ways Around the Rules*, N.Y. TIMES, Mar. 31, 2003, at C6.

2. U.S. General Accounting Office, *Internet Gambling - Highlights of the GAO-03-89*, at 1 (Dec. 2002), at <http://www.gao.gov/cgi-bin/getrpt?GAO-03-89>.

3. Tedeschi, *supra* note 1, at C6.

4. William Berling, *Bookies in Exile*, N.Y. TIMES MAG., Aug. 17, 2003, at 34-36.

government and an economy receptive to online gambling enterprises. The Costa Rican government welcomes any form of new investment and boasts a fairly sophisticated business environment capable of hosting large telephone and internet-based outfits.⁵ A large English-speaking population is ready to work for betting operations that need employees to take bets over the phone.⁶ Many of the proprietors are thirty- to forty-year-old men who had small, underground gambling operations in the United States. But now, out of the reach of U.S. prosecutors, they conduct international transactions and make substantial amounts of money in highly visible enterprises.⁷

Online gambling is one of the most popular forms of international e-commerce. Internet gambling accounted for \$6 billion of global sales in 2003, and of the 12 million online gamblers, 5.3 million are U.S. citizens.⁸

III. GAMBLING LEGISLATION

It is no surprise that such a high percentage of online bettors are in the United States, as most states either ban gambling altogether or impose strict limitations on it. Gambling regulation has traditionally been left to state law under the 10th Amendment. In many cases, however, the federal government can restrict internet gambling because of the interstate, and indeed extraterritorial, quality of the new technology.⁹

The concerns of legislators range from morality to the increased risk of fraud. Social costs of internet gambling include bankruptcies, crime, broken families, gambling abuse and addiction, and access by minors.¹⁰ Because organized crime is apparently involved in online gambling, legislators accuse operators of laundering money, defrauding customers, and maintaining lower standards of honesty and transparency than licensed casinos.¹¹

A. FEDERAL STATUTES

The primary statute used by the federal government to implicate online bookmakers is the Wire Act of 1961.¹² The Wire Act prohibits the use of wire communication for the purpose of knowingly transmitting bets or wagers in interstate or foreign commerce.¹³ While the U.S. Department of Justice asserts that offshore gambling web sites cannot legally accept bets from U.S. residents, many gambling proponents argue that the Wire

5. *Id.* at 34.

6. *Id.*

7. *Id.*

8. Tedeschi, *supra* note 1, at C6.

9. Antonia Z. Cowan, *The Global Gambling Village: Interstate and Transnational Gambling*, 7 GAMING L. REV. 251, 251 (2003).

10. John Warren Kindt & Stephen W. Joy, *Internet Gambling and the Destabilization of National and International Economies: Time for a Comprehensive Ban on Gambling Over the World Wide Web*, 80 DENV. U. L. REV. 111, 121-22 (2002).

11. Tedeschi, *supra* note 1, at C6.

12. Wire Wager Act, 18 U.S.C. § 1084 (2002).

13. *Id.* § 1084(a).

Act does not govern all internet gambling because some of it is done through satellite internet access rather than dial-up wire access.¹⁴

The most publicized internet gambling case to date is *United States v. Cohen*.¹⁵ Jay Cohen, co-owner of one of the largest sports bookmaking operations, World Sports Exchange (WSEX), was convicted of seven counts under the Wire Act and is now serving a twenty-one month prison sentence in Las Vegas.¹⁶ On appeal, the Second Circuit held that § 1084's safe-harbor provision did not apply and, therefore, WSEX was subject to the Wire Act even though the transactions occurred, at least in part, in jurisdictions where gambling was legal.¹⁷ The court applied the statute's plain language and determined that offshore gambling web sites engage in illegal transactions by simply accepting payment from bettors. Section 1084(b) provides a safe harbor for transactions that occur where "(1) betting is legal in both the place of origin and the destination of the transmission; and (2) the transmission is limited to mere information that assists in the placing of bets, as opposed to including the bets themselves."¹⁸ Of the twenty owners and operators of WSEX that were indicted, only Cohen chose to challenge the accusations, and two remain fugitives in Antigua still operating WSEX.¹⁹

A more recent obstacle for internet gambling operators is the USA PATRIOT Act of 2001.²⁰ This new federal law authorizes the Department of Justice to seize any offshore bank account that it believes is engaged in illegal activity, including sheltering the earnings of an internet gambling enterprise.²¹ As long as the Department of Justice serves papers on the foreign bank that it suspects of illegal activity, it can freeze the assets of the account in question.²²

As the law stands today, authorities can prosecute internet gambling operators and related parties under the Wire Act for accepting bets from U.S. residents, or they can freeze their offshore bank accounts. Individual bettors, however, are not currently prosecuted under federal law.²³ Accordingly, criminal and social concerns, along with the inability of federal prosecutors to reach some operators like the WSEX fugitives, have prompted U.S. legislators to introduce three different bills to prohibit internet gambling in the United States.

14. Optimal Gambling, *U.S. Gambling Legislation*, at <http://www.optimalgambling.com/legislation/usa.htm> (last visited Sept. 27, 2003) (on file with author).

15. 260 F.3d 68, 68 (2d Cir. 2001).

16. *Id.*

17. *Id.* at 73-75.

18. *Id.* at 73.

19. Cowan, *supra* note 9, at 260.

20. Solveig Singleton, Competitive Enterprise Institute, *Paypal Meets the Patriot Act* (Apr. 15, 2003), at <http://www.cei.org/gencon/016,03443.cfm>.

21. Internet Gaming News, *Is I-Gaming Within Biting Distance of the PATRIOT Act?* (Mar. 28, 2002), available at <http://www.gtlaw.com/pub/media/2002/obrienp02a.htm>.

22. *Id.*

23. Cowan, *supra* note 9, at 260-61.

B. PROPOSED BILLS

U.S. Senator Jon Kyl (R-Arizona) demanded that legislation "keep [pace] with technology" at a hearing on internet gambling before the Senate Judiciary Subcommittee, asserting that "[g]ambling is either heavily regulated or expressly prohibited in the states. On the Internet, it is neither."²⁴ The House and Senate have both made efforts since 1995 to prohibit internet gambling, but no attempt has been effective.²⁵ Three currently pending bills suggest that soon there will be a U.S. federal law specifically barring internet gambling.

1. *House Bill 1223*

Known as the Internet Gambling Licensing and Regulation Commission Act, House Bill 1223 establishes the Internet Gambling Licensing and Regulation Study Commission, and gives the Commission the authority to conduct a comprehensive survey of the existing legal framework governing internet gambling and the issues associated with regulating it.²⁶ This Commission would have broad powers to investigate the impact of internet gambling with respect to gambling addiction, accessibility to minors, money laundering by terrorists or criminals, and the role of payment systems that fund internet gambling.²⁷ House Bill 1223 was introduced on March 12, 2003, by Representatives John Conyers (D-Michigan) and Chris Cannon (R-Utah).²⁸ The bill was referred to the Committees on the Judiciary, Energy and Commerce, and Financial Services, and subcommittee hearings began in April.²⁹

2. *House Bill 2143*

Rather than simply reviewing the problems and potential solutions to the internet gambling issue, House Bill 2143 takes a more active approach. House Bill 2143 is referred to as the Unlawful Internet Gambling Funding Prohibition Act (UIGFP).³⁰ It would require payment institutions to distinguish restricted transactions with an authorization code and refuse to process them.³¹ Further, UIGFP would prevent acceptance of the products or services in connection with an identified gambling trans-

24. Kindt & Joy, *supra* note 10, at 122.

25. Mark D. Schopper, *Internet Gambling, Electronic Cash & Money Laundering: The Unintended Consequences of a Monetary Control Scheme*, 5 CHAP. L. REV. 303, 307 (2002), available at http://gaming.unlv.edu/resources/net_gaming.html.

26. Library of Congress, *Bill Summary and Status: H.R. 1223*, at <http://thomas.loc.gov/bss/d108query.html> (last visited June 6, 2004) [hereinafter *Summary H.R. 1223*].

27. Internet Gambling Licensing and Regulation Commission Act, H.R. 1223, 108th Cong. (2003).

28. Frank J. Fahrenkopf, Jr., *American Gaming Association: Federal Issue Update*, 11 NEV. LAW. 9, 10 (2003).

29. *Summary H.R. 1223*, *supra* note 26.

30. Unlawful Internet Gambling Funding Prohibition Act, H.R. 2143, 108th Cong. (2003).

31. Library of Congress, *Bill Summary and Status: H.R. 2143*, at <http://thomas.loc.gov/bss/d108query.html> (last visited June 6, 2004) [hereinafter *Summary H.R. 2143*].

action, as well as any other restricted transaction.³²

UIGFP passed in the House by an overwhelming majority after arguments to remove a provision enumerating states' rights was rejected.³³ In June 2003, the bill was received by the Senate, read twice, and referred to the Committee on Banking, Housing, and Urban Affairs.³⁴

3. Senate Bill 627

Senate Bill 627 is also called the Unlawful Internet Gambling Funding Prohibition Act.³⁵ This measure attacks internet gambling in the same way as its counterpart in the House, by cutting off funding mechanisms.³⁶ Senate Bill 627 seeks to control internet gambling by prohibiting people who are in the business of betting or wagering from knowingly accepting certain payment systems, credit cards, and electronic fund transfers in connection with another person's participation in internet gambling.³⁷ The foremost distinction from its House Bill counterpart is that Senate Bill 627 creates an Office of Electronic Funding Oversight in the Treasury Department.³⁸ This office is given authority to regulate internet gambling in an attempt to block payment on illegal transactions.³⁹

On July 31, 2003, the Senate subcommittee sent the bill for report, after amending it only with a substitution favorable to the bill.⁴⁰

IV. THE FUTURE OF OFFSHORE GAMBLING IN THE UNITED STATES

Though many gambling site operators admit that the proposed legislation will hurt their business and have already aimed more advertising dollars at Europe, there is confidence within the industry that bettors will find ways around the new rules. As the owner of one sports book assured *The New York Times*, "Will the legislation hurt us? Yes. Will we find a way around it? Yes. People will always find new ways to get money to us."⁴¹

Although online gambling sites accept debit cards, checks, and wire transfers, the predominant form of payment is credit card.⁴² Some large banks and credit card companies, including Visa and Mastercard, have refused to transfer money to offshore betting accounts because of the potential for fraud, but bookmakers circumvented these efforts by en-

32. *Id.*

33. Fahrenkopf, *supra* note 28, at 9.

34. *Summary H.R. 2143*, *supra* note 31.

35. Library of Congress, *Bill Summary and Status: S. 627*, at <http://thomas.loc.gov/bss/d108query.html> (last visited June 6, 2004) [hereinafter *Summary S. 627*].

36. Fahrenkopf, *supra* note 28, at 9.

37. Unlawful Internet Gambling Funding Prohibition Act, S. 627, 108th Cong. (2003).

38. Fahrenkopf, *supra* note 28, at 10.

39. *Summary S. 627*, *supra* note 35.

40. *Id.*

41. Tedeschi, *supra* note 1, at C6.

42. Joseph M. Kelly, *Payment Problems and New Solutions: From National Regulation to Global Solutions*, 7 GAMING L. REV. 123, 125 (2003).

couraging bettors to use debit cards or payment services like PayPal, Net-Teller, or E-CashWorld.⁴³ Conscious of these loopholes and the risk involved, many credit card companies have abandoned this extremely profitable market entirely.⁴⁴ In late 2002, when eBay acquired PayPal, a peer-to-peer payment system, it agreed to quit processing online gambling charges through PayPal at the insistence of the New York Attorney General, even though gambling charges made up eight to ten percent of PayPal's volume at that time.⁴⁵

There are three reasons financial companies refuse to process internet gambling transactions, even without the influence of new federal laws. First, most credit card companies state in principle that they simply do not want to risk being a part of illegal activity.⁴⁶ This approach is commendable because they have only been held liable in a few states, such as California, for their part in internet gambling transactions.⁴⁷ New legislation might bring changes, but historically courts have held that credit card companies are not criminally "involved" in the gambling.⁴⁸ For example, the Fifth Circuit Pattern Criminal Jury Instruction finds that a credit card company or bank "engage[s] in the business of betting or wagering" under the Wire Act if the defendant "[i]s prepared on a regular basis to accept bets placed by others—that is, the defendant [i]s a bookie."⁴⁹

Next, payment institutions realize that there is a real risk that bettors will not have to pay credit card bills for their internet gambling charges on the grounds that gambling debts are not legally enforceable in the United States.⁵⁰ Companies also worry about charge-backs, whereby a losing player might falsely report the card stolen to avoid liability for the gambling charges.⁵¹ Obviously this can only be accomplished by a single gambler once or twice with one credit card company, but it will still charge higher fees to offset the aggregate cost of these charge-backs.⁵²

Another way to circumvent the actions of credit card companies has been to pay through debit cards issued by foreign banks. However, the IRS may begin scrutinizing these more heavily.⁵³ The USA PATRIOT Act also gives the Department of Justice authority to take action against these accounts. Still, it is easy to see why internet gambling operators would prefer to use debit cards. Debit cards involve less risk since the

43. Tedeschi, *supra* note 1, at C6.

44. Nelson Rose, *Why Visa is Dropping Online Gambling*, 7 GAMING L. REV. 243, 243 (2003).

45. Carl Kaminski, *Online Peer-to-Peer Payments: PayPal Primes the Pump, Will Banks Follow?*, 7 N.C. BANKING INST. 375, 397 (2003).

46. Tedeschi, *supra* note 1, at C6.

47. Kelly, *supra* note 42, at 126 (citing Providian Nat'l Bank v. Haines, Case No. CV 98-08858 (Cal. Super. Ct. 1998); Marino v. American Express, Case No. CV 99-6166 (Super. Ct. Marino Co. 1999)).

48. See, e.g., *In re MasterCard Int'l Inc.*, 132 F. Supp. 2d 468, 481 n.5 (E.D. La. 2001).

49. *Id.*

50. Rose, *supra* note 44, at 244.

51. *Id.*

52. *Id.*

53. Tedeschi, *supra* note 1, at C6.

transactions are connected to a bank account that already has the customer's money in it and the money is automatically deducted as a final and immediate payment upon approval.⁵⁴

One Costa Rican online book, Sportbet.com, has begun using a novel payment system it calls "Personal Checks."⁵⁵ The website acts like a bank, submitting gamblers' checks directly to their checking account, rather than relying on a third-party financial institution to process the transaction.⁵⁶ Since the transaction is completed more quickly, both the bookmakers and bettors are pleased, and discriminating credit card companies and depository banks are taken out of the process altogether.

Moreover, despite the refusal of credit card companies and some U.S. banks to honor gambling charges, gamblers have discovered a way to spend their credit with these financial institutions anonymously online. Electronic money is a "digital representation of money," which is based on encryption technology that disguises the information so that only the intended beneficiary can retrieve its meaning, making it untraceable.⁵⁷ Hence, an online gambler can purchase electronic money with his credit or debit card legally, leave no trail revealing where he spends his electronic money, and gamble online without the banking entities identifying the codes for gambling charges that they would otherwise reject.⁵⁸ Though the benefit of privacy in internet payment transactions has been extolled, the anonymous nature of electronic money clearly has the potential to be abused to launder money and commit other financial crimes.⁵⁹ The federal government has expressed concern that electronic money will impede federal efforts to run surveillance of banking and credit card systems.⁶⁰

Considering the benefits these alternative payment systems provide, it is easy to see why internet gambling operators prefer them. Using electronic money, the transactions are not intercepted or even traceable by banking or government entities because they can be so well-encrypted and are virtually undecipherable and anonymous.⁶¹ Furthermore, bettors using these secure systems do not leave a paper trail and are better protected from identity theft.⁶² Gamblers also expect an immediate payment of wagers, and these alternative methods hasten the receipt of their winnings.⁶³ Therefore, alternative payment systems are encouraged by in-

54. RONALD J. MANN, *PAYMENT SYSTEMS AND OTHER FINANCIAL TRANSACTIONS* 144-45 (2d ed. 2003).

55. Kelly, *supra* note 42, at 127.

56. *Id.*

57. Schopper, *supra* note 25, at 314.

58. Kelly, *supra* note 42, at 127.

59. Schopper, *supra* note 25, at 313.

60. *Id.*

61. Sarah N. Welling & Andy G. Rickman, *Cyberlaundering: The Risks, The Responses*, 50 FLA. L. REV. 295, 321-22 (1998).

62. David D. Friedman & Kerry L. Macintosh, *The Cash of the Twenty-First Century*, 17 SANTA CLARA COMPUTER & HIGH TECH. L.J. 273, 278 (2001).

63. Schopper, *supra* note 25, at 313.

ternet gambling operators, appreciated by bettors, and mistrusted by the banking and government entities that try to regulate these very transactions.

V. CONCLUSION

In summary, while Congress appears to be close to enacting legislation aimed at cutting the funding sources of internet gambling, it may be driving online gamblers to more anonymous forms of payment.⁶⁴ This pending legislation and the self-initiated efforts of U.S. financial institutions will present substantial obstacles to gambling operators, but Congress has yet to find a permanent solution to new forms of electronic money laundering at the gambling enterprises' disposal.

64. *Id.* at 309.

Regional Integration: Comparative Experiences

